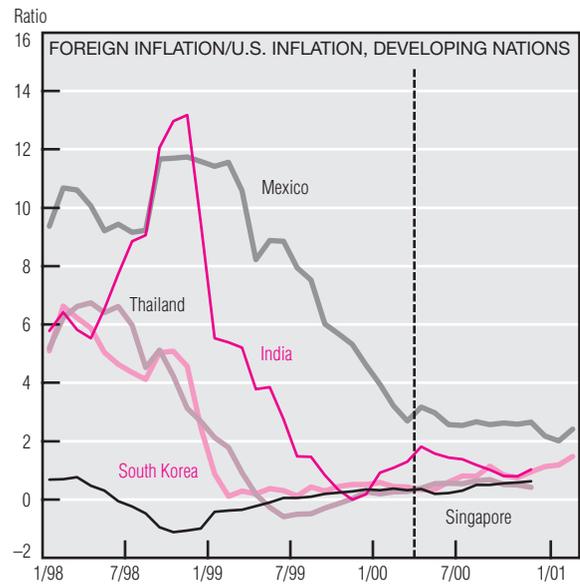
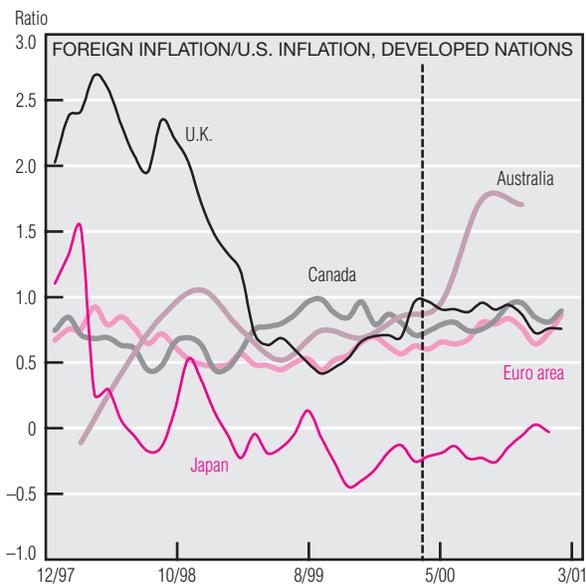
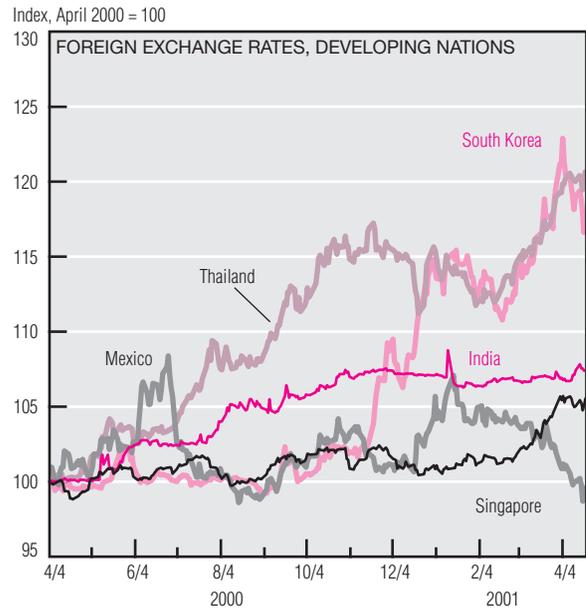
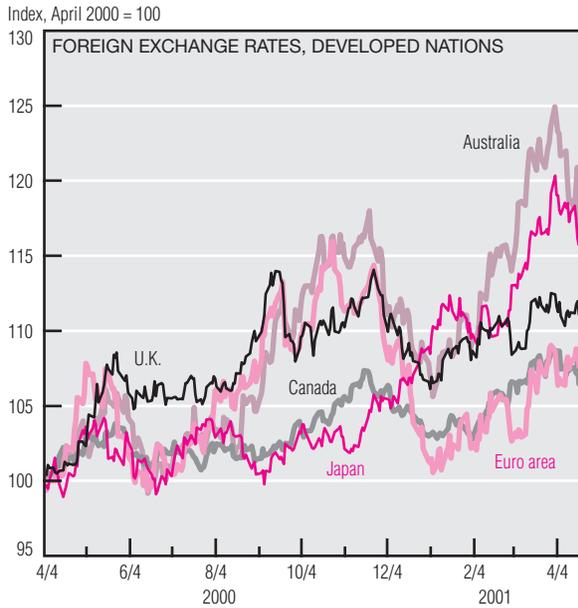


Foreign Exchange Rates



SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System; Banco de México; Bank Negara Malaysia; Bank of Japan; European Central Bank; Japan Ministry of Public Management, Home Affairs, Post, and Telecommunications; National Statistics Office of Korea; Organisation for Economic Co-operation and Development; Office for National Statistics U.K.; Reserve Bank of India; Singapore Department of Statistics; Statistical Office of the European Communities; Statistics Canada; and Thailand Ministry of Commerce.

The S&P 500 has declined 18% in the past year, and the NASDAQ has fallen 52%. One might expect foreign investors to have liquidated some of their U.S. holdings and reinvested the proceeds abroad; such reinvestment would cause the U.S. dollar to depreciate against other national currencies. With the exception of the Hong Kong (Hang Seng) index, however, which dropped more than 90%, most major international stock markets significantly outperformed the NASDAQ and performed comparably to other

U.S. stock indexes. Moreover, the U.S. dollar has appreciated greatly against most of the world's currencies. The U.S. dollar has gained against a large set of developed nations' currencies (Australia, Canada, euro area, Japan, and the U.K.). The Canadian dollar and the euro depreciated the least (slightly more than 5%) during this period, while the Australian dollar depreciated more than 15%. The story is similar for developing nations (India, Mexico, Singapore, South Korea, and Thailand), of which only Mexico's currency did not depreciate.

Comparative inflation rates cannot explain exchange rate movements over the past year. Since April 2000 (the dashed vertical line in the lower charts), the U.S. inflation rate has been comparable to or higher than most other countries, except Australia and Mexico. (In these charts, a higher U.S. inflation rate is associated with a number less than one.) Perhaps our strong fiscal position and prospects for future growth relative to other countries account for continued foreign capital inflows over the past year and a consequent appreciation.